UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Electricity Market Design	**)**	**Docket Nos. RM01-12-000, RT01-2-000,**
and Structure	**)**	**RT01-10-000, RT01-15-000, ER02-323-000,**
(RTO Cost Benefit Analysis Report)	**)**	**RT01-34-000, RT01-35-000, RT01-67-000,**
	)	**RT01-74-000, RT01-75-000, RT01-77-000,**
	)	**RT01-85-000, RT01-86-000, RT01-87-000,**
	)	**RT01-88-000, RT01-94-000, RT01-95-000,**
	)	**RT01-98-000, RT01-99-000, RT01-100-000,**
	)	**RT01-101-000, EC01-146-000, EC01-3000-000,**
	)	**RT02-1-000, EC02-9-000, EC01-156-000,**
	)	**ER01-3154-000 and EL01-80-000**

Comments by the Michigan Public Service Commission on the Federal Energy Regulatory Commission Cost/Benefit Study on RTO Development

Pursuant to the Commission's "Notice of Regional Teleconferences and Due Dates for Comments and Reply Comments" issued in the captioned dockets on March 1, 2002, the Michigan Public Service Commission ("Michigan") hereby submits its initial comments on the RTO Cost Benefit Report (hereinafter "study" or "report").

Study Responds to Request by the States for RTO Investigation

Michigan is pleased that the Federal Energy Regulatory Commission ("FERC") undertook this study. A recent resolution of the National Association of Regulatory Utility Commissioners, adopted on July 12, 2001, identified the need for further investigation regarding the size, scope, and economic basis supporting RTO development and urged FERC to commence a study. Our colleagues at FERC are to be commended for listening to our request and following through with a positive response, resulting in initiation of this study. This action is another example of the positive working relationship developing between FERC and the States, a relationship that is highly valued by Michigan. The States and FERC share a mutual interest and commitment to foster competitive wholesale electricity markets. Cooperation is vital, as the stakes are high and resources to address the many complex issues are limited.

State Participation in Study Advisory Role

State Commissions were invited by FERC to serve in an advisory capacity to the study. Six state Commissions, including South Carolina, Vermont, Ohio, Washington, Utah, and Michigan, assisted with the investigation, in a limited, although important role. The advisory role of the states focused primarily upon scenario development. However, in the process, representatives from participating states gained valuable insight about the study objectives, the workings of the model, key assumptions used, and the expertise and experience of the consultants performing the investigation. One of the meetings with the state advisory group was held at the offices of ICF, the consulting firm conducting the investigation.

Participation was much appreciated and helpful to our understanding of the study and our ability to comment on the resultant findings. State Commission involvement in the conduct of this study is yet another example of the positive and productive cooperation between the states and FERC on RTO development. Not only did the Commission respond affirmatively to our request to conduct the study, our FERC colleagues went a step further and invited us to participate in the investigation.

Study Purpose and Scope

As stated in the Executive Summary of the report, the study was commissioned "to examine the potential economic costs and benefits of a move toward Regional Transmission Organizations." The key operative word is "potential". The study appropriately set out to quantify the potential benefits and costs associated with improved transmission system operations and enhanced energy market performance resulting from RTO development. The study tested the premise that properly structured RTOs could result in market improvements. In other words, RTOs represent the means or vehicle to achieve market improvements. Attempting to measure the value of these market efficiency improvements in terms of benefits in relation to the associated costs would prove helpful in addressing the threshold question: "Are the potential savings generated from RTO development large enough to justify their development costs?"

Given the embryonic stage of RTO development, that is an appropriate objective for such a study. This was a topic of considerable discussion by the State advisory group. The scope, objectives, and applicability of the study results were clearly articulated by the researchers and generally understood by the advisory team.

Measuring potential benefits and costs appropriately frames the study as "directional" as opposed to definitive in supporting RTOs as vehicles to drive market efficiencies. At this juncture, this approach is among the best available to assist with decisions to evaluate RTO development potential. Strong positive findings imply significant opportunities for addressing market performance through RTOs, but do not prove this will occur. Unfortunately, a study to provide such a definitive proof does not exist. Since RTOs are under development, there is no means to present any statistical verification to prove their effectiveness. Until they become fully operational, support for them will necessarily rely upon predicted expectations. Studies such as the cost/benefit study performed by the ICF Consulting group can be invaluable in making such assessments.

Waiting for a study to prove effectiveness will only result in a do nothing response. Until RTOs are in operation, you cannot measure their performance. And, if you cannot measure RTO performance, you cannot prove effectiveness – the "chicken or the egg dilemma - which comes first?" The answer is, of course, unknown and irrelevant. Irrelevance applies here for those seeking a definitive proof study as apposed to a predictive analysis, or what we describe herein as directional guidance. Relevant decisions about RTO development must be made on the basis of sound predictive analysis. The ICF cost/benefit study performed for FERC is appropriately framed to provide such valuable guidance. As RTOs develop and become fully operational, a more definitive type analysis will become possible. Such studies may be helpful down the road to guide and fine-tune them. However, at this time, predictive analysis must be relied upon.

Model Selection

Assessment of market performance on a regional basis within the entire United States over a 20-year period is a monumental undertaking. The complexity and scope of this task is enormous. Markets are dynamic. Inter-regional trading patterns, fuel prices, energy demand, environmental constraints, transmission restrictions, plant locations and efficiencies, are among the many variables that must be factored into the analysis. Few models are capable of credibly handling the task. The ICF Integrated Planning Model (IPM) has a proven and accomplished record in performing this type of analysis.

The ICF IPM relies upon dynamic computer simulation to forecast power system changes and economic outcomes under varying conditions. As stated in the report, the methodology "enables a detailed quantitative assessment of potential costs and benefits over long periods, taking into account interactions between power markets, fuel and environmental markets." In order to reliably make these predictions, an enormous volume of information is required. Equally important, numerous assumptions must be carefully factored into the model to simplify the multitude of complex interrelationships into a manageable number upon which meaningful analysis can be performed. Development and maintenance of such modeling capability is very expensive and costly. Highly specialized expertise is required.

The ICF IPM approach is a tried and tested methodology for performing the type of comprehensive analysis called for in the FERC cost/benefit study. The IPM has been in existence for many years and has a long history of successful application. As reported in the cost/benefit study, this model has been used on numerous occasions to address complex energy issues at the national level similar to those under investigation in this study. It has also been relied upon at the state level. In the late 1980s Michigan contracted with ICF to develop a model to assist with the State's resource planning for the electric industry. A Michigan version of the IPM ("Electricity Options for Michigan: Results from the Michigan Electricity Options Study", Michigan Department of Commerce, 1987) was successfully employed to conduct resource

planning studies for several years. As a result of this experience, Michigan is quite familiar with the modeling approach employed by ICF. Based upon this experience, we are impressed with IPM as a technically sound and powerful tool to conduct the complex type of analysis FERC commissioned to assess potential RTO benefits. The model's distinguished track record over time at both the national and state level provides convincing evidence of IPM's capability to provide credible results in this most complex area of analysis. Few, if any, models can match its technical competence to simulate dynamic regional energy markets throughout the United States. All things considered, the ICF IPM was an excellent choice to perform the complex analysis commissioned by FERC.

ICF Reputation for Energy Market Analysis

ICF possesses a distinguished reputation for performing complex energy market analysis. The firm has performed numerous analyses similar in scope and complexity to that at issue in this docket. Researchers employed by ICF are internationally recognized for the expertise and experience they possess and the quality of their work product. Michigan's experience contracting with ICF for development of a state integrated planning model provides empirical evidence in support of this conclusion.

Study Results

Savings were expected to result from market efficiency improvements. The relevant question was centered upon how significant would they be and how would they stack up against the costs of developing RTOs. Indeed savings were identified by the study. In fact, projected savings were most impressive. As reported in the Executive Summary "Once policy changes are fully in place the results suggest that $1-10 billion per year in economic gains could result." The magnitude of potential market efficiency savings in relation to RTO development costs, projected as a one-time expense of $1-1.5 billion, is an attention grabber.

Improved power plant operational efficiencies and enhanced demand-side management deployment are conservatively projected to produce production cost savings of 5.6%. Most states

are projected to see wholesale price reductions ranging from 2-10%. Additionally, reduced reserve margin requirements, along with more efficient dispatch of power generation facilities and increased reliance upon demand-side management will decrease the number of generation facilities needed to meet future electricity demand.

Clearly, savings projections of this magnitude lend solid support for continued RTO development. The opportunity for enormous savings to be captured by improved transmission operations and market efficiency improvements potentially resulting from RTOs cannot be overlooked. Michigan is convinced that the results from this study provide the green light for continued and expeditious RTO development.

Results from the study also suggest that RTO size matters, with greater benefits to be derived from larger RTOs in comparison to smaller ones. Michigan urges FERC to take notice of this as it moves forward with RTO design decisions. We continue to support a single, large RTO for the Midwest region and believe this study supports our position on this important RTO design issue.

Next Steps

The results of this study lend firm support for continued efforts to move forward on RTO development. Successfully achieving the benefits will require careful development of RTOs to ensure that they successfully deliver market improvements that produce the projected savings identified in the ICF cost/benefit study. RTOs must be independently structured, the markets served by them must be effectively monitored to ensure competitive operation, and market power mitigation measures must be rigorously enforced. These are issues addressed in ongoing FERC proceedings and are appropriately addressed in those dockets. They are raised here simply to emphasize the importance of decisions on these matters as they relate to the ability to capture the huge benefits identified in the cost/benefit study. To capture those benefits, RTOs must be properly structured so that they can effectively address market performance issues. Successfully doing so will transform the “potential” savings quantified in this study into “real” savings to be

passed along to electricity customers. That is a goal worthy of vigorous pursuit. It is also one uniting us in our common effort. The state/federal partnership to improve wholesale market efficiency is a winner for everyone. Let's get on with it! More studies will not get the job done. What is called for now is action to move swiftly on effective RTO development. Michigan pledges to stand shoulder-to-shoulder with our neighboring states and FERC to assist with this important venture.

Respectfully submitted,

MICHIGAN PUBLIC SERVICE COMMISSION

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